Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

COMMENTS OF SUREWEST COMMUNICATIONS

SUREWEST COMMUNICATIONS

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SUMMARY

SureWest Communications is the parent of SureWest Telephone, a mid-size incumbent local exchange carrier ("ILEC") that provides about 130,000 access lines in northern California between Sacramento and Reno, NV. SureWest Communications' subsidiaries are leaders in northern California in providing advanced services – including digital IP-based television, wireless services, fiber-based CLEC services, DSL, and high-speed (up to 20MB) Internet services. SureWest believes that some modification of the current intercarrier compensation regime is merited. However, the existing intercarrier compensation system does not need to be replaced or radically restructured.

The record does not support any of the plans in their current form at this time. None of the proposals in their current form fully address the public interest issues present in this proceeding. Some of the plans have elements that are attractive, but each has flaws that are significant. Moreover, none of the proposals has been supported by backup data at a level of detail sufficient to allow evaluation of the impact of the plan on industry and end users.

The issues presented to the Commission by most proponents of plans go beyond intercarrier compensation reform. A pure response to intercarrier compensation concerns would be limited to changes in rules for cost recovery or network use that modify rates and rules only within the carrier community. Many of the proposals recommend additional fundamental change to other Commission policies. Nevertheless, SureWest believes that the Commission could better address intercarrier compensation by also addressing some related issues, such as universal service. Indeed, any action that would lower ILEC switched access traffic sensitive rates must be

accompanied by revisions that would generate an equivalent amount of offsetting ILEC revenue elsewhere, which implies that the cap on end user charges must also be reassessed.

The magnitude of the changes to carrier compensation advocated by some proposals, and the potential financial impact of these proposals, counsels for caution. Action in this proceeding requires a solid record and detailed documentation as to the likely resulting impacts on carriers and customers. That detail is not present in the record at this time, is not likely to be created quickly. None of the plans made available for comment in the FNPRM is accompanied by financial information adequate to assess its full impact. The overall public interest impacts of each plan simply cannot be measured at the level of confidence that has been expected in the past by this Commission for similar issues and policy decisions. While more and better data may be provided at some point during this proceeding, the current gap has prevented parties from being able to adequately comment on the public interest impacts of each of the plans. Future *ex partes* alone will not cure that inadequacy.

Three plans are given more detailed review here, the plans of the Expanded Portland Group (EPG), the Alliance for Rational Intercarrier Compensation (ARIC), and the Intercarrier Compensation Forum (ICF). These and other plans all tend to anticipate the need for a residual funding access recovery mechanism (ARM) to cover access revenue shortfalls. Briefly, with respect to each of these plans:

EPG: The EPG plan would ultimately rely on port and link charges for revenue recovery, and it provides for an access recovery mechanism to compensate carriers for revenue losses due to the application of the plan. The EPG plan includes new policy designed to capture previously-unrecoverable charges related to phantom traffic, a policy that would serve the public interest and which could be implemented independently of any plan.

The EPG plan would have both intrastate switched and special access rate levels move over time to the interstate rate levels and rate structure. Such an approach is contrary to the public interest. Special access tends to have unique characteristics, and there are many business and other considerations with special access that cannot be predicted in advance. The EPG plan assumes that reciprocal compensation rates are or can be made nearly comparable to access charges. In most cases, this is simply not true, and could make an existing problem worse.

The EPG plan's ARM-like Access Restructure Charge (ARC) is triggered by a "benchmark" of residential rates and the SLC. This concept has some merit, and would more fully balance rates nationwide, but is not well developed at this time.

The use of ports and links would seem to be most appropriate only for the most rural carriers, whose service areas are characterized by limited points of access by interexchange carriers and others, and a diverse customer base that is not easily accessible except through the ILEC. When boundaries begin to erode, and new avenues in and out of a service area are possible, the port and link could suffer. Also, there would be opportunities for gaming with a plan that provides flat rate service based on links: capacity can be adjusted, a carrier can move its traffic to fewer links, terminating carriers could find terminating alternatives, and significant economic incentives exist to evade the very points at which the charges would be assessed.

ARIC: The ARIC plan appears to be designed primarily to respond to the express concerns of the very smallest rural carriers, who apparently have concluded that competition and the threats of IP-enabled services will not be significant in their marketplace until sometime far in the future, if at all. It is not appropriate for most of the areas served by other ILECs.

The plan anticipates unprecedented state and federal cooperation. In theory, this could work if local rates were to be rebalanced across the country so as to be at equivalent levels and to accommodate the same regulatory changes. Rebalancing needs to be considered in any plan. However, rate rebalancing has not occurred except in a few states, including California. Therefore, the plan could depend on a "perfect storm" - a concurrent measured approach by all of the diverse state commissions to create unified SLC levels, develop rebalanced rates and develop a new universal service support fund. This is unlikely to occur.

The plan also calls for full regulation of IP-based services under Title II, which SureWest believes would be contrary to the public interest. The ARIC plan does, however, recognize the need for a new compensation regime based on cost causative factors as the network migrates to IP-related services. There appears to be merit in an approach that recognizes the distinctions between retail IP-enable services and the wholesale transport of such communications, and puts in place a compensation scheme that recognizes the costs caused and burdens created by these activities.

ICF: The ICF plan is the most aggressive in seeking significant change in both intercarrier compensation and other Commission policies. The ICF plan was accompanied by rough estimates of aggregate impact, but the record has yet to see the backup data that led to those estimates, and there is no record data of the impacts on individual carriers, or customers. This lack of data is a significant problem.

The strongest aspect of the ICF plan is its documentation of technical interconnection options, and the related recommendations. These recommendations properly attempt to maintain constructive *status quo* arrangements wherever possible, and to require minimal reconfiguration. However, they fail to address network arrangements for carriers like SureWest, which include a tandem and a stand-alone end office.

The radical nature of the rate structure recommendations made in the ICF plan are contrary to the public interest. The plan would take usage-based rates down to a level that would substantially reduce the ability of ILECs to recover their costs. While the ICF plan also includes an ARM-type arrangement, it uses two separate support funds, with one for the smallest "rural" carriers, and another for remaining adversely-affected rate of return ILECs. The funds are identical except for the fact that the support in the latter fund is portable. SureWest believes that there is no need for two funds, and that any portability mandate would frustrate achievement of the ARM's intended goal.

Once the plan's four-year phase-in was completed, ILECs would face a new and pernicious form of arbitrage, because competitors would ultimately have access to the ILEC's local network at costs lower than the costs that the ILEC itself would have to assume with respect to its network. This would be the case even though these competitors continue to cause significant costs for ILECs to provide access and related services to them. The result would be a form of reverse "price squeeze". This anomaly disserves the public interest. It is unclear whether the ICF plan can be modified to address this and other issues that are raised.

It is unclear where SureWest would fit into the ICF plan, since it is a rate of return carrier that is not classified as a rural company. SureWest currently is ineligible for non-rural high cost universal service support because the rules disqualify carriers based on the state they are in. Likewise, SureWest would not qualify for the ICF's new and narrow "CRTC" classification. Yet, SureWest is a high cost carrier due to geological factors and because it also lacks the economies of scale and scope of other, much larger non-rural carriers -- including others who receive non-rural high cost support. Thus under the ICF plan, SureWest's switched access rates would fall, for all practical purposes, to zero, and it would be handicapped in its ability to recover its costs elsewhere. Therefore, any cost recovery would be relegated to the ICF plan's ARM-like ICRM fund. However, the portability feature of this fund (which doesn't exist in the ICF's TNRM fund) would ensure that at least some of this funding - claimed to be intended to put companies like SureWest in the position they would have been in had there been no intercarrier compensation reform - would *never* become available to SureWest. This new support mechanism would fall far short of putting SureWest Telephone into a position where it has a fair opportunity to recover its costs, creating harm not just for the company, but also for its customers.

The results of the ICF plan for companies like SureWest would appear to be contrary to the Commission's pro-competitive, market-oriented telecommunications policies. Instead of recovering its revenues from its current diverse base of carrier and other provider customers, companies like SureWest would now be relegated to getting more than 50% of their non-local-rate revenue from governmentally-mandated support funds, with more than 35% obtained from the ICF plan's new and untested ICRM. This little-discussed, but nevertheless significant consequence would create a new and substantial form of financial risk on SureWest and other ILECs -- and also on their customers -- because the source of funding required to deliver service would now be significantly less diversified. Small changes in the ICRM could have significant service-affecting impacts. This problem would exist for all plans that would move switched access usage rates close to zero.

Therefore, SureWest recommends that the Commission take action consistent with the following:

> First, it should recognize that ILEC networks have significant value to all who use them. There remains a universal need for ILEC networks to remain healthy and accessible to all. It is in the public interest for all users of local networks to compensate local carriers for that use. Access rates that are for all practical purposes at or near zero do not do this, and create new and dangerous arbitrage opportunities.
>
> Second, there is no need to force ILEC switched access rates for circuit-based services down as far as the ICF, Western Wireless, CBICC and other recommendations suggest, ultimately requiring the replacement of those losses with offsetting governmental supports for many ILECs. The Commission should therefore reject these plans in their current form.
>
> Third, if there is a compelling need for access reductions beyond what can be accommodated through offsetting SLC changes, some additional avenues for cost recovery are essential. This could be achieved with the use of alternative rate elements that operate consistently across customer groups (some commenters have identified the possibility of a small flat rate originating charge), or through a single new ARM-like structure - a structure that must allow ILECs a fair opportunity to recover their costs. Since the purpose is to provide an alternative avenue for cost recovery, the Commission should not discriminate among ILECs in eligibility for such a fund, nor should conditions for recovering

from it differ among carriers. Any new support mechanism should not operate to make ILECs newly dependent on indirect support fund payments -- this lends strength to the view that usage-based rate reductions should be measured, and that alternative revenue sources should be preserved.

Fourth, if the Commission determines that economic efficiency is to be the driver in this proceeding, it should not selectively apply that rationale. It is hard to conclude that an economic result would be achieved if the Commission determined that some form of bill-and-keep regime should be put in place for switched access, without addressing similar economic efficiency issues with the SLC, or without addressing -- and correcting for -- the likely new arbitrage opportunities that such activity would promote.

Finally, the Commission should concurrently address issues related to universal service reform, expanding the contribution base, and aligning better the entities that might become entitled to high cost relief. To the extent that the Commission has to deal with the same fundamental policy issues on a recurring basis in telecommunications, a "unified" approach has merit.

SureWest otherwise concurs generally with comments to be filed by USTA that promote commercial negotiations of intercarrier compensation arrangements and address the establishment of a default mechanism for carriers unable to come to agreement. SureWest also concurs with USTA's comments on the mechanics of network interconnection, on transit service, on elimination of the intra-MTA rule for CMRS, and on the recovery of lost intrastate access revenue.

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SureWest Communications ("SureWest") respectfully submits these comments in response to the Commission's Further Notice of Proposed Rulemaking ("FNPRM") in this proceeding, FCC 05-33, released March 3, 2005. These comments address the global issues raised by the FNPRM, and also address the more specific impacts that would occur with respect to SureWest and its customers.

I. INTRODUCTION

SureWest is a small, publicly-held company, listed on the NASDAQ, whose telecommunications and other subsidiaries all operate primarily in Sacramento and Placer Counties, California.[1] SureWest's primary operating subsidiary is SureWest Telephone,[2] an incumbent local exchange carrier (ILEC) that provides approximately 130,000 access lines to customers in and around Roseville, California. SureWest Telephone is the fourth largest ILEC in California, but lacks significant economies of

[1] Placer County runs from the Sacramento area north and east into the Sierras and to the Nevada state line.

[2] SureWest's other subsidiaries provide, among other things, a Sacramento fiber optic transport network, out-of territory competitive telecommunications services, fiber- and IP-based digital television service, Internet access and hosting, wireless PCS, and directory services.

scope and scale – it serves fewer than 0.1% of the nation's ILEC-provided access lines, and fewer than 1% of the ILEC-provided lines in California.

SureWest is the only independent company in California that is not classified as a "rural telephone company",[3] and therefore it is automatically disqualified from eligibility for federal high cost universal service support.[4] This is the case in spite of its own unique cost characteristics.[5] SureWest Telephone participates in the NECA common line pool, but otherwise has its own interstate access tariffs on file at the Commission. Its provision of intrastate access is comprehensively regulated on the state level.

Action by the Commission in response to the FNPRM could have significant adverse ramifications for SureWest Telephone and its customers. Some of the proposals on which comment has been invited would be very harmful to universal service and inimical to the public interest. Therefore, while SureWest's comments are

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[3] The Commission has defined a "rural carrier" and a "rural incumbent local exchange carrier" as incumbent local exchange carriers that meet the definition of a rural telephone company as set forth in section 153(37) of the Act. 47 U.S.C. 153(37). The Commission has created two distinct high cost mechanisms – one for rural telephone companies using historical costs, and a general, non-rural high cost fund, based on a forward-looking cost model. *See* Ninth Report and Order, Federal-State Joint Board on Universal Service, 14 FCC Rcd 20432 (1999) and Tenth Report and Order, 14 FCC Rcd 20156 (1999).

[4] Current Commission policy denies qualification for high cost universal service support to any ILEC not designated as rural telephone company that operates in a state where the average rate is below the national average. No California non-rural carrier can qualify for this support. Yet SureWest lacks the scope and scale of the predominant urban ILECs. As a result, the customers of SureWest Telephone in California cannot receive local service at rates that are "reasonably comparable" to those of the much larger adjacent Bell Company, SBC California. The Commission's actions establishing the rules for non-rural high cost support have been rejected twice, and are again before the Commission on remand, in part to align reasonably comparable urban rates with equivalent rural rates. Qwest Corp v. FCC, 258 F.3d 1191 (2001); Qwest Communications Intl v. FCC, No 03-9617 (11^{th} Cir., 2005).

[5] SureWest Telephone's service area has certain characteristics that cause comparatively high costs. A residual substrate of granite or of Merton soil, called "lava cap", lies just below ground level in much of its service area. Lava cap is a vestige of ancient volcanic activity in northern California, and it makes outside plant construction significantly more expensive than would otherwise be anticipated. That excessive cost can be as much as three times normal costs. This characteristic is completely unrelated to whether an ILEC is located in a rural area or not.

directed generally at the plans and the various changes suggested in them, these comments originate from a company that is concerned about the impact on its own ability to remain healthy and to meet its own obligations to customers and shareowners.

II. THERE IS A NEED FOR SOME MODIFICATION TO CURRENT INTERCARRIER COMPENSATION ARRANGEMENTS.

In SureWest's view, the process of intercarrier compensation, including the process by which carriers and providers compensate ILECs for use of their networks, could benefit from reform. While many commenters in this proceeding will characterize the system as "broken", that characterization is an overstatement. In fact, there are many aspects of today's intercarrier compensation and access structure that serve constructive ends, and that will continue to be necessary to achieve the objectives of the Act for the foreseeable future.

Why is there a need for reform? There are a number of reasons:

- Arbitrage. An inefficient market encourages arbitrage. The current intercarrier compensation marketplace is not as efficient as it could be. Some of this inefficiency is caused by public policy distinctions and classifications that are not necessary in today's environment. There is merit in seeking to address arbitrage and to reduce or eliminate it where practicable. Arbitrage that exploits the current pricing system and leads to the imposition of costs on others should be addressed.

There are numerous opportunities for exploitation today – the system has become Byzantine, and some providers have become "chameleons" in order to take advantage of artificial pricing opportunities. A provider can variously characterize itself as an IXC, CLEC, ISP, VOIP provider or other type of entity to take advantage of existing rules and to reduce its costs. There has been arbitrage between jurisdictions for many years, with such abuses as point of origination misrepresentation and opportunistic traffic routing. There also has been arbitrage between the long distance and local jurisdictional arenas, where incentives for mischaracterization of traffic and improper commingling have long existed, and have been inadequately policed. At this time, the greatest concern for self-interested arbitrage, and the amount that raises the greatest public policy concerns, is arbitrage based on how providers characterize themselves and their traffic. Because of variations in pricing and regulatory rules, different prices are being paid for equivalent forms of traffic that cause substantially similar costs.[6]

Unlike some commenters, SureWest is not necessarily an advocate for the adoption of identical rates for all carriers for all services in this proceeding. First, differences in prices may be justified by differences in the services. Second, the achievement of the optimum public interest balance of competing policy demands may require compromises, as has been the case in the past.[7] The best course may be to take steps that will significantly deflate arbitrage incentives, to reduce them to levels where any resulting distortions are not disruptive, but not to create new ones in the process.[8]

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[6] Arbitrage is recognized as a strategy that generates zero-risk profits, involving the simultaneous purchase and sale of equivalent assets, where investors take advantage of discrepancies in price relationships. In this proceeding, the assets can be seen as contract rights to use carrier services. (However, if the carrier services are not equivalent, the differences may justify different prices and arbitrage may not be present.)

[7] Specifically, this means that while SureWest supports a move towards a consistent rate framework for access and intercarrier compensation, it does not necessarily believe there is a need to insist on identical rates.

[8] Policy tradeoffs must occur, for example, where greater recovery of those costs that are believed to be non-traffic-sensitive through flat rates is desirable, but external considerations create pressures to cap such rates at levels that would make such cost recovery impossible. The example in the next footnote illustrates a new and perhaps more harmful form of arbitrage opportunity that would be created by one or more of the plans in this proceeding that offer a purported bill-and-keep “solution”.

More significantly, the presence of arbitrage does not require that the Commission eliminate the obligation of carriers and others to pay a share of the costs needed to operate local networks they use. To seek the elimination of arbitrage while severely undermining cost recovery would be inconsistent with the Commission's obligations under the Act.

Likewise, the present extent of arbitrage does not require that the Commission erase or eliminate the distinctions between local and other traffic. In fact, in order to achieve the optimum balance of policy considerations in this proceeding, this distinction has a continuing valid and essential place, and should still play a significant part in determining how ILECs should be paid for use of their networks.[9]

- Response to Fundamental Market Change. The basic telecommunications marketplace is changing and the participants in the market are also changing. To the extent practicable, the intercarrier compensation framework should be positioned to accommodate the likely fundamental service shifts in the future.

Any framework for dealing with the future needs to accommodate, or at least start to accommodate, the commingling of circuits and minutes with the emergence of bits in telecommunications. As IP transport expands, the regulatory world needs to make adjustments accordingly. This adjustment should include some level of

[9] An example illustrates the continuing need to deal with local service as a unique service offering and to continue to require that there be fair compensation for the use of ILEC local networks. In a situation in which no distinction is made between local and interexchange networks, and access rates are, for all practical purposes, reduced to zero, regulatory policy would harm ILECs. VoIP competitors to an ILEC who use interexchange carrier networks would be able to use the ILECs network to compete against the ILEC without making any contribution to cover ILEC network costs at all. The ILEC itself would be forced to assume costs caused by both the VoIP provider and its interconnecting carrier. The ILEC also would be assuming its own network costs as well. With little or no cost to terminate its "local service" traffic, the VOIP provider -- and its interconnecting carrier -- would be able to exploit an entirely new form of pricing aberration to the detriment of the local carrier. This presents an undesirable new arbitrage situation in itself. It would be prejudicial to ILECs, would cause ILEC residential customers using the ILEC's network to subsidize others, and would ultimately be harmful to universal service, as well as to maintainence of the network.

deregulation.[10] Today's regulatory scheme is ill-prepared to measure and allocate costs based on bits and capacity as opposed to circuits and minutes.

Even in a world increasingly driven by the transport of bits, circuit switching will be present for a long time to come. Regardless of the nature of the traffic sent over a network – whether in minutes or bits - the network operator must be able to recover its costs in order to deliver its services. The erosion of access lines through competitive alternatives and the emergence of VoIP already places real pressure on ILECs to look ever more closely at the economics of their businesses. These and similar recent trends should not cause the Commission to prejudge either the future or the pace of change. It certainly counsels against precipitous action that would leave ILECs with residual governmentally-mandated support flows as the *only* realistic source of revenue recovery. That would appear to directly contradict a policy that is identified as seeking a pro-competitive and market-driven future. Any revised framework can accommodate emerging technology, without discarding positive aspects of the current arrangements.

- <u>Promotion of New Services</u>. Adjustments to the current process of intercarrier compensation and access payments can provide better signals to the marketplace regarding incentives for new investment and opportunities for innovation. This must be done, however, without undermining the fundamental transport capabilities of networks that participate in the public switched telephone network. SureWest

[10] The Commission may elect to affirmatively consider two parallel telecommunications regulatory schemes – one for the handling of circuit-switched telecommunications and one for the handling of bits. In some ways, that is what exists today, with the handling of bits largely characterized by the absence of significant regulation. It is contrary to the public interest, however, to suggest that if a transmission is "bit-based", or uses IP, it should automatically be insulated from <u>any</u> possible regulation or contribution to offset the costs of the networks being used. The proposals before the Commission here all anticipate that regulatory obligations will be present with IP-based traffic, including fundamental matters such as participating in universal service contribution mechanisms, compliance with network reliability, security and emergency access requirements (like E-911), and accommodating basic interconnection.

believes that local networks remain the most important underlying contributor to the success of the Internet and related Internet-based services. Even with the presence and growth of cable modem service, no Internet can exist without the huge array of individual telephone connections that exists in every local service area. This is not likely to change in the near future.

- Cost Recovery. Evolution of the markets covered by the Commission's rules has altered the ability of ILECs to recover their costs. In light of this evolution, it is even more important today to carefully assess the opportunities for cost recovery of ILEC networks in light of the presence of many at least partial alternatives. Simply providing for minimal compensation for network use is not enough. Many ILEC commenters would describe their concerns in terms of the "three legs of the stool" – arguing that every regulatory decision that reduces cost recovery from one of their three basic sources of revenue, or "legs" (i.e., access charges, end user charges and universal service support) must offset that loss through a compensatory opportunity for cost recovery elsewhere with one of the other two "legs". This remains a consideration here, where either existing Commission rules or facets of one or more proposals for reform would either limit the opportunity for cost recovery, or effectively prohibit it.

There are some new avenues to improve cost recovery in this proceeding. First, what has been called "phantom" traffic – traffic with critical identifying information stripped out or otherwise missing – is recognized as a great source of earned but unrecoverable carrier revenue in many areas of the industry. Modifications to current rules should be made to eliminate network exploitation involving this traffic. [11]

[11] This traffic mislabeling does not need to be deliberated from the comments in this rulemaking. Much of this activity is simply fraudulent with the intentional mislabeling of traffic or removal of call record information designed for the sole purpose to decrease costs.

Second, most plans would deal with the cost recovery ripples of the policy changes they seek by promoting a new form of transitional or long term support. The only way in which such a new system of supports could be implemented would be through an expansion of the base of contributors to this support, and a requirement that these newly proposed contributors share in funding the existing and new support mechanisms. The size and reach of this new form of support raises some fundamental questions about how privately owned common carrier networks should be treated under policies that are intended to be pro-competitive and market-based.

- Promote Neutrality / Fairness. Many of the plans are based on claims that the current system has treated providers and their traffic in a manner that is not competitively or technologically neutral. There is value in seeking ways to be evenhanded in the regulatory treatment of providers of all kinds – provided that they perform the same activities and shoulder the same obligations as those to whom they seek to be compared. Otherwise, neutrality could actually create a form of favoritism.

Local carriers emphasize strongly that action here should be done in concert with universal service reform. SureWest concurs. SureWest has a unique concern in that the current rules operate unfairly with respect to its own customers, and that the current universal service rules penalize them.[12]

[12] The operation of the current universal service rules directs USF funds from customers of SureWest to customers of other carriers in California and elsewhere, even though some of those carriers are larger, have lower costs, and/or are in comparable situations in other states – the key difference being that those other states have different statewide average rates. Certainly the operation of this universal service mechanism would become even more of a concern for SureWest under any plan that reduces usage-based rates significantly.

There are likely to be numerous other considerations that surface in comments. This list is not intended to be exhaustive. It reflects those policy drivers that appear to be the most significant.

III. THE PROPOSALS IN THIS PROCEEDING RAISE ISSUES THAT GO BEYOND INTERCARRIER COMPENSATION REFORM.

Despite its characterization, this proceeding is not limited to intercarrier compensation. Intercarrier compensation is but one of many fundamental policy concerns implicated by the proposals on which comment has been requested.

If the Commission had stated that its objective was to keep the overall amount of the contribution made to cover ILEC network costs by all carrier access charges, wireless termination and reciprocal compensation at substantially the same levels, and to adjust the charges paid by each group of providers or for specific types of carrier traffic in relation to one another, this would be exclusively a proceeding on intercarrier compensation. However, most of the proposals on which comment has been requested here go much further. Not only do they seek to adjust the structure and levels of intercarrier compensation, they would significantly impact at least four other core public policy issues:

<u>First</u>, they promote a fundamental change in the nature of compensation from end users. Two core questions that have necessarily been placed before the Commission in this proceeding as a result of various proposals are *whether* more of the costs of operating local networks should now be shifted to end users, and if so, *how much*. While this proceeding may be couched in the language of “intercarrier” compensation reform, the fundamental additional question of “*who pays*” reaches far beyond carriers to all customers of ILEC networks.

The proposals recognize that if the Commission is to prescribe rates or take other action that would significantly affect the regulated revenues of comprehensively regulated carriers, it must provide alternative opportunities for realistic cost recovery. Most of the proposals on which comment is requested would move some cost recovery to end users. Whether or not the imposition of additional cost recovery burdens on end users is in the public interest is an issue that has been addressed in detail in the past and requires renewed Commission attention. If some additional cost recovery from end users is appropriate, the amount of that shift and the extent of the expected cost recovery are issues that also require Commission attention.[13]

If the huge switched access charge rate reductions proposed in some plans in this proceeding are enacted, there are only a few alternative avenues for cost recovery. Certainly, there are public policy and political concerns that counsel against transfer of all of the otherwise-lost revenue recovery responsibility to end users, regardless of the economic merits. If the Commission decides to limit recovery from end users of the costs shifted from carrier access charges and other provider rates, it must then either find another way to provide for realistic cost recovery, or it must abandon efforts to shift such high levels of costs.

<u>Second</u>, there is the issue of universal service. While commenters here may make claims that the intercarrier compensation framework is "broken", there are reasons to suggest that the universal service framework is also "broken". Indeed, the two frameworks are intertwined. A healthy universal service compensation framework is essential to deal constructively with intercarrier compensation issues.

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[13] The marketplace now provides adequate – indeed, strong - controls over high SLC levels. Publicly-held ILECs have been consistently reporting access line erosion in the past few years. None would wish to accelerate that erosion through increases in SLC rates that would make that problem worse.

There are numerous unanswered universal service issues that remain pending at the Commission. The most obvious concern is that the amount of the contribution expected from the current base of contributors has increased dramatically in recent years. Yet there are many other users of ILEC networks whose businesses are tied to telecommunications that are completely exempt from contributing to the system.

In SureWest's own case, its inability to qualify for any federal high cost support while similarly situated ILECs in other states may do so, has removed one critical revenue recovery "leg" of the stool for it that could help it deal with the cost recovery shortfalls that would result from some of the pending proposals. For SureWest and others, some alternative cost recovery mechanism (or as some commenters call it, an access recovery mechanism (ARM)) would be essential if the Commission drove usage-based switched access rates too low. Even with an ARM available to it, SureWest remains concerned that moving cost recovery that it currently obtains directly from a diverse group of carrier customers to compensation through a large and non-diverse general support fund would itself threaten its ability to achieve its common carrier universal service obligations. This runs contrary to basic principles of finance, and increases SureWest's risk, as well as the risks to its customers.

<u>Third</u>, some proposals may alter the regulatory framework in a way that will improperly drive competitive advantages to certain market participants, and prejudice ILECs in the emerging marketplace of the future. For example, there are significant competitive advantages that will accrue to interexchange carriers from the ICF recommendations and from other bill-and-keep or near bill-and-keep proposals. These advantages will increase as access rates decline toward zero. The most obvious benefit would be that their most significant business expense will go down – perhaps to

zero, for all practical purposes. In turn, their enterprise values will go up – at the expense of local access providers. In addition, the proportion of any offsetting ARM or universal service support that they would pay would drop significantly with a broader contribution base. These firms could be put in a competitive position in which they could burden local networks with traffic without responsibility for any of the newly caused costs, and they could actually underprice ILECs for identical services provided over ILEC networks -- because only the ILEC would have to cover its network costs. The relative amount of regulation for these carriers vis-à-vis ILECs would essentially be eliminated, while ILECs would remain subject to highly detailed pricing rules and conditions.

Finally, to the extent that any proposals would ultimately move intercarrier rates downward, and put in place what is substantially a "bill-and-keep" structure with inadequate opportunities for cost recovery for any single ILEC, "takings" issues are raised. Just as the Commission cannot compel carriers to operate at a loss, it cannot prescribe regulatory action that would eliminate a common carrier's ability to recover its costs and to earn a fair return.

IV. THE COMMISSION SHOULD MAINTAIN CONSISTENCY WITH PAST DECISIONS IN SIMILAR PROCEEDINGS.

Some of the compensation and cost recovery questions raised by proposals in this proceeding have come up in numerous other earlier Commission proceedings. Repeatedly, the Commission has concluded that the public interest requires an allocation of cost recovery among all network users – interconnecting carriers and others who use local networks, as well as end users. In reaching this conclusion, the Commission has balanced the economic principles (which favor allocation of all network fixed costs to flat rate cost recovery from end users) against the universal service and cost recovery impacts.

When access was first identified as a separate service, initial access rates were designed to evolve from the preexisting settlements processes. While the Commission's relevant decisions were intended to foster an increasingly cost-based access rate structure, they were also intended to assure that the transition to an access charge structure would not cause harm by precipitous cost changes for end users and other customers for local services.

One of the proposals on which comment was invited at the very initiation of an access charge regulatory regime was a pure "bill-and-keep" option, moving the recovery of all non-traffic-sensitive (generally considered fixed) costs to end users. The shift would have been significant. While it had economic characteristics similar to those identified here that made it attractive in concept, this option was ultimately rejected. It was seen as harmful to the continuation of universal service, putting subscribership at risk.[14] It was also seen by some as extending an undeservedly generous "free ride" to interexchange carriers, who placed special cost and other burdens on local carriers,[15] that had to be recovered somehow. Thus, when an interstate flat rate end user charge was introduced, a substantial portion of the costs of providing local network access continued to be allocated to interconnecting carriers.

While this initial implementation of access charges was recognized as not being completely economically efficient, the Commission elected to take a measured

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[14] *See,* Third Report & Order in MTS and WATS Market Structure, 93 FCC 2d 241, 278 (1983).

[15] *Id.* at page 301.

approach that did not place fundamental objectives of the Act at risk.[16] Since that time, the industry has seen an almost-uniform reduction in carrier charges and a stepped increase in end user charges. The gradual adjustment in the levels of these charges has moved the industry closer to an economically efficient structure in a measured way – without placing universal service at risk, and without the need to put most of the burden of cost recovery on end users in a "bill-and-keep" type of structure.

The most recent set of adjustments in access charges – those made under the CALLS plan - has been consistent with these general principles. The Commission was able to identify a stepped series of gradual rate adjustments that matched usage-based rate decreases with offsetting flat rate increases. The adjustments were not disruptive for local exchange carriers or their end users and other customers.

The lessons of prior access charge proceedings remain useful in the context of this rulemaking. These lessons counsel in favor of spreading costs widely, and in favor of measured steps. It remains in the public interest for ILEC costs to continue to be recovered from all users of ILEC networks, including interconnecting carriers.

V. THE COMMISSION MUST ADDRESS SOME NOVEL LEGAL ISSUES TO ADOPT ANY PLAN.

A number of novel legal issues are raised by this proceeding. The parties proposing plans have generally identified these issues in their submissions, and have sought to assure the Commission about the Commission's authority to act in the way that they advocate.

PREEMPTION. The most significant generally-applicable issue is whether the Commission has the authority effectively to unify rates for interstate and intrastate

[16] *Id.* at page 278, and pages 365-66 (Separate Statement of Commissioner Fogarty).

access charges through preemption.[17] There are clear benefits to such action, but also concerns.

It is unclear that the Commission has this authority. Until now, it has been the case that the spheres of interstate and intrastate telecommunications regulation have been reasonably separable, and the respective mandates of state and federal law have nevertheless been met. The question now demanding more detailed examination is whether, in light of a changing marketplace and the need for some newly-focused regulatory policies, the Commission cannot achieve its federal regulatory objectives and mandates without prospective preemption. This requires a careful critical analysis of the circumstances in order to justify broad preemption. Certainly, this cannot be done until the record is far more complete than it is at the moment.

EXPANSION OF THE USF CONTRIBUTION BASE. The second most significant generally-applicable issue is whether the Commission has the authority to expand the contribution base for universal service contributions to include additional providers of services that directly or indirectly use or benefit from telecommunications networks, including providers of network-based information services and VoIP. The same legal question appears to be present whether the Commission moves from the present arrangement to a contribution base that is based on connections or one that is based on numbers (or "addresses").

SureWest believes the Commission has authority to expand the contribution base under Section 254 of the Act to ensure that "(e)very telecommunications carrier that

[17] The Commission also asks whether it must refer any issue in this proceeding to a Federal-State Joint Board. Arguably, preemption of the field would put all costs in the interstate jurisdiction and would eliminate the need to address any question about the appropriate division of costs between the federal and state jurisdictions. In other words, no jurisdictional separation of costs would exist any longer – costs would now be unseparated.

provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms . . . to preserve and advance universal service." The Commission can take this action even with regard to entities that are not recognized as traditional telecommunications carriers, as long as they engage directly or indirectly in telecommunications, and take advantage of telecommunications networks to offer their services.

The current revenue-based methodology could be retained, but it would increasingly have competitive consequences affecting the relative success or failure in the marketplace of contributors and non-contributors. It is not yet clear that the proposals in any individual plan offer the best alternative for implementing a broader contribution base. (The "units"-based gradations set out in the ICF plan cause separate concerns, for example.) However, the fundamental authority of the Commission to broaden the base appears secure, particularly if the Commission also unifies rates for access charges.

WHETHER ANY MOVEMENT TO BILL-AND-KEEP COMPLIES WITH SECTION 252(d)(2) OF THE ACT. The Commission asks about numerous costing issues. The most significant question is whether the Commission can prescribe bill-and-keep and yet adhere to Section 252(d)(2) of the Act.

While the incremental cost of a transmission on fiber from point A to point B over an interexchange carrier's network now may approach zero, that is not necessarily the case for transmissions on ILEC networks. ILEC networks are consistently subject to cost pressures to accommodate new service capabilities, to serve customers (including carrier customers), to deal with rapid changes in technology, and to remain competitive with providers of other networks. ILEC costs may not fit the two classifications of fixed and variable, and in fact may sometimes be semi-variable – varying significantly and/or often, not continuously, but in steps, at certain trigger points or capacity limits. These costs are not fixed. Accordingly, SureWest does not believe that a bill-and-keep access regime would comply with section 252(d)(2).

PRESCRIPTION. The Commission cannot "prescribe" a rate under the Act without following the Act's various requirements, including taking action that will assure that affected carrier(s) continue to have a realistic opportunity to recover their costs and to earn a fair return. If the Commission elects to establish a single rate or group of rates across all ILECs, the Commission has to be sensitive to its obligations under the Act, and it must address carrier-specific unique characteristics or anomalies that might limit that realistic opportunity for carriers in a wide variety of different circumstances to recover their costs.

VI. THE COMMISSION SHOULD BE MINDFUL OF CERTAIN PUBLIC INTEREST PRINCIPLES.

The Act provides some touchstones that must guide the Commission's action in this proceeding.[18] The Commission itself has identified a number of driving policy considerations.[19] At very least, Commission action in this proceeding must adhere to the following principles:

- Development of efficient competition,
- Preservation of universal service support,
- Technological and competitive neutrality, and
- Minimal regulatory intervention.

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[18] 47 U.S.C. 151

[19] FNPRM at paras. 29-36

In considering action here, it is important that the Commission not lightly assume that no matter what it does, ILECs will remain viable. Today's market does not automatically permit that assumption.

Therefore, the Commission's principles in this proceeding also should include:

- Creation and/or maintenance of financial incentives to build and to improve local networks;
- Recognition of the realities of today's differing network architectures and their relative complexity; and
- Maintaining necessary cost recovery opportunities for affected local and other carriers.

Certainly, the overwhelming majority of today's telecommunications users still rely on ILEC networks for services. This is not limited to end users alone. Wireless providers require connections to reach landline customers and to move traffic from their towers to a network. CLECs that resell local services depend on local carriers for origination and termination. Interexchange and Internet providers also use ILEC networks in the origination and termination of traffic.

Internet providers raise a special case. As the Commission understands well, there is really no separate Internet. The networks it utilizes are the physical networks of various carriers. Many of the costs of delivering Internet traffic are buried in the rates paid by interexchange carriers for access, and in turn they are paid to the interexchange carriers by Internet companies via wholesale commercial traffic agreements. The fact that an Internet provider may be the customer of an interexchange carrier does not change the fact that costs are incurred by a local carrier involved in providing that access.[20]

An ILEC's failure to be able to recover its costs renders it uneconomic for a local provider to offer that access, and places the local carrier at risk. It also puts at risk each of the networks that depends on the ILEC network. In turn, this includes the Internet itself. Thus, there always needs to be an arrangement in place that allows for adequate compensation and cost recovery.

VII. THE RECORD DOES NOT SUPPORT ANY SINGLE PLAN AT THIS TIME.

For the reasons set out above, the record in this proceeding does not support any single plan, and SureWest recommends that each of the plans be rejected. As noted elsewhere, no proposal has been supported by backup data at a level of detail sufficient to allow evaluation of the impact of the plan on the industry and on individual carriers' end users.

The lack of detail and back-up support for the proposals in this proceeding contrasts starkly with past proceedings proposing similarly broad changes to the

[20] There has been much discussion about whether the interconnection of local and interexchange networks could be made to fit the "peering" model of Internet transport providers. But Internet "peering" typically involves the interconnection of networks that are primarily "point to point". Local networks are very different from these "peering" networks. They have unique last mile complexity. They are more costly to maintain. They are more constrained with respect to standards and requirements common to other networks of their type around the country. They do not simply go from one point to another – the routes are not fungible. ILEC networks operate a true "web" in each local community, with each connection having its own unique physical characteristics and limits. The architectures, costs and relative obligations on each side of an interconnection (or peering) point would be much different. In effect, ILEC and peering networks would be completely different "species" of network. Thus, the underpinnings of "peering" cannot apply to the current public switched telephone network. While some of the physical aspects of peering interconnection at network edges could become useful as local networks evolve, the nature of the traffic handled on each side of an ILEC-interexchange carrier interconnection point makes it inappropriate to conclude that the relative burdens and benefits are equal – or even comparable. A review of standard Internet peering agreements would make those differences apparent – standard peering agreements contain conditions designed to assure that the relative traffic flows and transport burdens are going to be equivalent. If these terms cannot be met, peering is denied. Likewise, it is also rroneous to conclude that the value of the exchange of traffic between an ILEC and interexchange carrier network is equal, or that the incremental cost of such exchange to each carrier is equal.

economics of the wireline telecommunications industry. For example, prior to the enactment of the access charge regime, the Commission issued four separate Notices of Inquiry/Proposed Rulemaking to explore in detail and in logical sequence not only the relevant issues, but the specific proposals for such a regime.[21] When the Commission contemplated shifting certain carriers from rate-of-return to the price cap regulatory regime, it provided even more extensive opportunities for analysis of the details of the proposed price cap rules. First, it issued a Notice of Proposed Rulemaking.[22] Having received 75 sets of comments on that initial Notice, the Commission subsequently requested that parties submit draft price cap rules, and it received 17 sets of such rules, with 31 sets of comments and reply comments on the drafts of rules.[23] Based on those submissions, the Commission issued a Further Notice of Proposed Rulemaking ("*FNPRM*").[24] This *FNPRM* had 326 pages of analysis, not just of the prior comments, but of the economic calculations underlying the proposed rules. Notwithstanding the extensive analysis already in the record, the Commission properly concluded that additional issues needed to be addressed before price cap theories could be translated into a workable regulatory system.[25] The *FNPRM* included 19 pages of proposed rules

[21] *See*, MTS and WATS Market Structure, Notice of Inquiry and Proposed Rulemaking, 67 FCC 2d 757 (1978); Supplemental Notice of Inquiry and Proposed Rulemaking, 73 FCC 2d 222 (1979); Second Supplemental Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 224 (1980); Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 FCC 2d 177 (1980); Fourth Notice of Inquiry and Proposed Rulemaking, 90 FCC 2d 135 (1982).

[22] Policy and Rules for Rates for Dominant Carriers, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987).

[23] *See*, Policy and Rules for Rates for Dominant Carriers, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3476-77 and 3479-81 (1988) for documentation of the draft rule submissions and comments responsive thereto.

[24] *Id.*

[25] *Id.* at para. 17.

that carriers could review in detail, to analyze the impact on their specific operations. In response to comments on the *FNPRM*, the Commission enacted price cap rules for AT&T, but recognizing the vast differences between ILECs and AT&T, as well as the diversity among ILECs, the Commission issued yet another Further Notice of Proposed Rulemaking seeking comments on price cap rules for ILECs.[26]

SureWest recognizes that many parties have claimed that there is an urgent need for the Commission to enact broad intercarrier compensation reform immediately. As discussed above, while there are reasons for enacting reform, the need to not jeopardize the current economic basis for the public network has been largely ignored.

While it is commonly claimed that VOIP is the “disruptive technology” that will shortly overwhelm the current intercarrier compensation system, the Commission must be mindful of the fact that the vast majority of telecommunications traffic in this country will not be VOIP and will continue to be circuit based for a number of years. There is no need for the Commission to panic, and to abdicate its obligation to move carefully and methodically toward an outcome that reflects the public interest assessments of the Commission, and not of self-selecting industry groups.

If the Commission determines that it is appropriate to make changes in its current intercarrier compensation structure, and those changes affect the existing access charge regime and universal service framework, the Commission should make adjustments that move the industry toward a better overall outcome - but it must not remove the opportunity for adequate compensation for ILECs. If the Commission determines that a reduction in access charges is appropriate, the amount of the change

[26] Policy and Rules for Rates for Dominant Carriers, Report & Order and Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989).

made should be limited to that which can be matched by offsetting rate adjustments, so that ILECs can recover otherwise-unrecovered costs.

VIII. THE COMMISSION HAS SOUGHT COMMENT ON INDIVIDUAL PLANS.

The Commission has requested comment on the plans identified in the FNPRM. Only three "plans" of those identified in the FNPRM could ultimately form the basis for some action, after the details are better defined and the financial impacts are known. Of these, two, EPG (Expanded Portland Group) and the Alliance for Rational Intercarrier Compensation (ARIC)[27], provide little impact data, while only one, the ICF plan, has provided any aggregate impact calculations. These plans are discussed below, while other plans are addressed in more summary fashion in Appendix A. Also, since the release of the FNPRM, additional plans have been filed or announced, making it likely that this proceeding will not have the benefit of full comment on all of the emerging proposals.[28] The following comments on the EPG, ARIC, and ICF plans are provided for Commission consideration.

EPG PLAN: The end goal of the EPG plan is to migrate to a regulatory structure that relies on charges on ports and links rather than usage to permit ILECs to recover lost revenue. The plan is insufficiently detailed to allow commenters to determine the revenue impact on industry participants or customers. Like other plans, it relies heavily on ARM-type funds to make carriers whole for lost revenue sources. It

[27] At this time, many parties refer to the EPG and ARIC plans together as the Rural Alliance plan. Because there were many incompatible aspects of the plans subject to ongoing discussion, SureWest elected to treat the plans as separate in these comments. For instance, their joint public documentation makes no mention of capacity-based systems, which is a linchpin in the EPG plan.

[28] For example, filings by the Frontier subsidiaries of Citizens Communications and by NARUC were made just before the comment due date. CTIA also recently announced its own intercarrier compensation plan.

relies on a “stepped” process for implementation over a four year transition period. The intent of the plan appears to be to keep ILECs as close to their financial status quo as possible, while addressing the most harmful arbitrage issues. SureWest agrees that a transition approach would be necessary to absorb the changes for both the consumer and the companies. However, because the EPG plan focuses on rural carriers, as a non-rural rate-of-return carrier, SureWest remains uncertain of the way in which it would be treated.

The EPG plan recognizes the presence of “phantom traffic” and sees it as a source or otherwise-lost revenue that can be put to work to ease the transition. As a result, it would require what have been called “truth in labeling” requirements, to assure that traffic is measured and billed. The plan relies on enforcement through the options of call termination or application of default tariff structures. SureWest supports addressing this issue immediately, including through the options provided in the plan. As discussed previously, this is a large and growing source of revenue loss associated with increasing costs of service.

The EPG plan would also provide that the ESP exemption be severely limited, a move that makes sense in light of amount of time that has passed since the exemption was put in place, and the change in the marketplace. If it is kept at all, it should be limited to use only as a way to preserve affordable dial up Internet connections, and should not shelter termination of VoIP traffic. In SureWest’s view, the ESP exemption has served its purpose and now should be affirmatively eliminated.

The EPG plan would have intrastate switched and special access rate levels move over time to the interstate rate levels and rate structure. This plan assumes all special access should be treated similarly. Special access services have unique characteristics. For this reason, affirmatively forcing an alignment of special access with switched access would be contrary to the public interest.

The EPG plan assumes that reciprocal compensation rates are or can be made nearly comparable to access charges. In most cases, this is simply not true, and mandating reciprocal compensation to mirror access charge levels would increase most states reciprocal compensation rates significantly above present levels. This would make the existing arbitrage opportunities worse. The interplay of access rates and reciprocal compensation rates is one reason to maintain the local and long distance rate distinctions.

The EPG plan uses an ARM-like Access Restructure Charge (ARC), which is triggered by a benchmark of residential rates and the SLC. This concept has some merit, and would more fully balance rates nationwide. It would not require distribution of funds to carriers that have lower rates and would not penalize those that have had rates rebalanced in a state. However, the operation of this ARC would need to be spelled out in much greater detail to assess its usefulness on a widespread basis, and to assess the level of funding that would be required to implement it adequately. The rate specified in the plan for pooling may be appropriate, but there are no data submissions to prove that its assessment would be adequate.

The plan offers a capacity-based system, put in place after rate unification, that is intended to reflect the characteristics of a packet-switched network. Unlike many commenters who advocate a "hands-off-the-Internet" approach to IP-enabled services, this plan confronts the issue, and appears to have concluded that it must do so to achieve important public policy objectives in a future telecommunications environment.

The plan's use of ports and links seems appropriate for most carriers only where there are limited routes for access to and from a community, few carriers and a well-dispersed, diverse customer base. When boundaries begin to erode, and new avenues in and out of a service area are possible, the port and link concept may not survive. There could be inherent weakness and gaming in a system that provides flat rate service based on links where capacity can be adjusted, a carrier can move traffic to fewer links, terminating carriers can find non-ILEC alternatives, and economic incentives exist to evade the very points at which the charges would be assessed. For this reason, such a capacity driven plan in its present form would not be consistent with the public interest.

The EPG plan appears to seek a continuation of status quo technical interconnection arrangements and meet points. This is consistent with other plans that seek to avoid disruption of current arrangements. The plan might require small and 2% ILEC tandem owners to carry traffic unreasonable distances outside of their serving area. The tandem owners would then be burdened with substantial new costs. Such an approach would be contrary to the public interest.

ARIC PLAN: Similar to the EPG plan, the ARIC plan focuses on providing support to the traditionally rural high cost areas with a "hold harmless" transition period. The ARIC plan assumes that after a transition, any remaining shortfalls will be recovered fully by residual state funds. That assumption is of questionable validity.

The ARIC plan is detailed and designed primarily to respond to the express concerns of the smallest rural carriers. There has been a great deal of thought to balance the needs of these small carriers on a time line that coincided with their belief that competition and the IP market will not be significant in their marketplace until a date that is at least five years in the future.

The plan anticipates unprecedented state and federal cooperation. In theory, this could work if local rates were to be rebalanced across the country so as to be at equivalent levels and to accommodate the same regulatory changes. However, there has not been significant rate rebalancing except in a few states, including California. Therefore, the plan would depend on a measured rational approach by 50 diverse state commissions to create unified SLC levels, develop rebalanced rates and develop a new universal service support fund. This is unlikely to occur.

The plan also calls for some Internet transmission services to be regulated as telecommunications under Title II of the Communications Act. Such a mandate that all Internet-related or IP-based services should be treated as Title II services would be contrary to the public interest.

The ARIC plan does, however, recognize the need for a new compensation regime based on cost causative factors as the network migrates to IP-related services. There appears to be merit in an approach that recognizes the distinctions between retail IP-enable services and the wholesale transport of such communications, and puts in place a compensation scheme that recognizes the costs caused and burdens created by these activities. ARIC uses a form of session billing in its plan, adjusted for quality of service considerations.

SureWest would be concerned, however, about an ILEC's ability to collect the fixed cost component of certain broadband connections only through DSL charges. Unlike the ILECs described in the ARIC plan, carriers like SureWest would not have the backstop of universal service to make up revenue shortfalls from activity seeking revenue from IP services.

As in the EPG plan, SureWest's position is not expressly addressed as a rate of return, non-rural carrier. In many of the components of the ARIC plan there is no reference to such carriers. If the plan were to be implemented as submitted, it is unclear how it would apply to SureWest.

ICF PLAN: Based on the data available in its current form, the ICF plan will not achieve its stated objectives. It could actually create new arbitrage situations for ILECs, and would threaten universal service for many carriers. Moreover, despite its characterization as being more attuned to market forces, it preserves a thoroughly regulatory environment for ILECs. SureWest agrees with some aspects of the ICF plan, and disagrees with other aspect of that plan, but its main concern is that the plan could strangle its ability to recover its costs. As applied to SureWest in its current form, it would likely harm SureWest local customers.

There are a number of positive aspects to the ICF proposal. Its technical interconnection suggestions are attractive.[29] The ICF plan also has constructive recommendations with respect to the treatment of universal service – particularly in its recommendations related to the expansion of the contribution base. It is unclear whether the Commission has the authority to take some of the steps proposed in the ICF plan. If the Commission determines that it lacks any of the authority to take some of the critical steps, that gap alone would make the ICF plan unworkable.

[29] They are, however, incomplete. The interconnection provisions do not, for example, reflect the network architecture of carriers like SureWest, which involves both a tandem arrangement and a separate end office.

The application of the rate restructuring aspects of the ICF plan to SureWest would be harmful, and SureWest expects it would be harmful to other ILECs as well. This plan shares a common flaw with some other plans in that it appears that SureWest's fundamental cost recovery issues have not been adequately addressed, due to SureWest's status as a small, rate of return ILEC that is classified as non-rural. While it lacks the economies of scope and scale of other non-rural ILECs, SureWest would be ultimately be saddled with newly-unified, prescribed usage rates limited to less than 1% of its current switched access rates, and that would, for all practical purposes, go to zero. Its main existing sources of alternative revenue would be capped or denied altogether.

For all practical purposes, the ICF plan would put in place bill-and-keep for all but the smallest ILECs. Its carrier distinctions permit only a very small subset of uniquely-defined "covered" rural ILECs to maintain a continuing low terminating access rate just below one cent per minute, while all other ILECs would have a near-zero rate prescribed for them. This distinction between the ILECs is a privately-negotiated one, unrelated to any public policy assessment. Certainly, it does not tie to any statutory definition of a rural telephone company, a 2% carrier, or any NECA subset 2 and 3 carrier groups. It would leave a number of ILECs, including SureWest, in a position where they would be unable to realistically recover their costs in any other way.

The effective operation of the ICF plan would be to eliminate essentially all of the switched access revenue most ILECs now derive from a diverse market-based group of customers, and establish a different new "remedy" – a new governmentally-mandated support fund that would become the ILEC's single largest source of revenue. Taken with the modest sources of funding support SureWest now receives on the state and interstate levels, and holding its current state support constant, SureWest still would eventually be getting more than 50% of its non-local-rate revenues from support funds. That outcome appears inconsistent with the pro-competitive policies of this Commission and the Act.

This concentration of revenue sources would add significant new financial risk to the operations of carriers like SureWest. Unlike an otherwise-identical support fund set up for the very rural ILECs, the fund for rate of return carriers who don't fit the ICF's narrow protected rural class is portable. Thus, even though this fund is touted to be one that could make carriers like SureWest whole, and even though its size would be determined by some mechanism that is claimed to measure the costs that carriers would have recovered in the absence of the ICF plan's reforms, SureWest actually has no assurance that it will even receive these new support funds. In other words, although the new fund would be established to help SureWest offset the specific shortfall created by the ICF plan, the support flows themselves actually might be directed to other providers - including providers who are not competing with SureWest today. This would undermine the basic concept of cost recovery, and accordingly, SureWest asserts that a separate fund subject to portability does not serve the public interest in this case The Commission can find a better alternative that is consistent with the objectives of the Act.

There are some other fundamental aspects of the ICF plan that are contrary to the public interest. For example, the ICF plan's implied elimination of distinctions between local and other traffic is unwise, because that distinction still has significant merit for any future ratemaking framework (certainly for a circuit-based ratemaking framework). Furthermore, the structure of the plan also leaves some other issues open

– the handling of 8YY traffic (including the treatment of 8YY database queries), for example.[30]

Rather than addressing special access directly, the ICF plan relies more on the cross-elastic effects of switched and special access to drive down special access rates. The ICF option appears to be preferable to the other plans with respect to special access, because special access requires significant individualized implementation, and all of the variations required in the special access area cannot be predicted in advance.

Lastly, the ICF plan appears to be intended primarily as a transitional plan to deal with the ILEC-centric provision of voice services in a circuit switched environment that is not expected to survive very long. Thus, the ICF plan appears to be less concerned about the short term impacts on ILECs and their customers. However, notwithstanding some of the positive aspects of this plan, the implementation of the ICF plan could be very disruptive for a sustained period of time, causing significant negative ripple effects long after the initial transition is completed.

IX. THE COMMISSION MUST ACCOMMODATE THE IMPACTS OF ANY CHANGE ON SUREWEST AND OTHER SIGNIFICANTLY-AFFECTED LOCAL CARRIERS.

In reviewing the proposals in this proceeding, SureWest has become increasingly concerned about the possibility that, if the Commission prescribes significant reductions in access rates without providing for reliable alternative sources of revenue, SureWest

[30] See ICF plan at note 22. 8YY traffic is of ever-increasing significance for ILECs. The handling of 8YY traffic and the handling of 8YY database queries could dictate the success of any of these plans for many ILECs. Historically, the Commission's policies and rules required that terminating access rates be charged to the originating "open end" of an 8YY call. In part, this was based on the fact that the calling party pays nothing for the call, and the called party is responsible for its cost. This same principle remains applicable today. Therefore, the Commission should maintain its current policy, including its policy for the handling of queries, in any action it takes on intercarrier compensation, unless compelling record evidence shows the need for change.

Telephone's ability to recover its costs and earn a fair return will be so threatened that it may not be able to continue to provide a high level of service to its customers.

As all plans recognize, there are limited sources of revenue for ILECs affected by reductions in access charges. Most ILECs of SureWest's size or smaller count on at least three primary sources of switched access-related revenue: inter- and intrastate switched access charges, subscriber line charges, and universal service support. In fact, SureWest Telephone has fewer sources of revenue than other midsize and small ILECs, because SureWest Telephone does not qualify for high cost universal service support under its present non-rural status, a status which SureWest believes is improper.[31] If SureWest's otherwise-unrecovered costs were forced upward significantly by any action in this proceeding, the Commission's rules would therefore have to be changed in order for SureWest to receive any high cost universal service support.

This means that with any reduction in switched access charges, absent the creation of a new alternative, SureWest would be able to recover any shortfall in only one way – through increased subscriber line charges. Unless the aggregate revenue reduction anticipated from access charge reductions were carefully limited, any cap on SLCs will effectively prevent SureWest from using that avenue for recovering access charge revenue losses.

[31] Based on information set out in the most recent Federal-State Joint Board Monitoring Report, at Table 3.8, urban carriers can qualify for high cost support under the Commission's non-rural high cost fund support program in ten states: Alabama, Kentucky, Maine, Mississippi, Montana, Nebraska, South Dakota, Vermont, West Virginia and Wyoming. More than 50% of the fund's 2004 total distribution of more than $265 million is distributed within one state - Mississippi. Three regional Bell companies receive 65% of the fund. Most recently, BellSouth accounted for 40% ($107 million), Verizon accounted for 14% ($37 million), and Qwest accounted for 10% ($27 million). See Monitoring Report at Table 3.24.

Yet, the alternative of using an ARM raises concerns as well. Not all ARMs and ARM alternatives are defined the same or operate equivalently. The ICF plan provides two such ARM-like funds that are very different from one another, described as an ICRM fund and a TNRM fund. Eligibility for one or another fund depends on whether a rate of return carrier is in the narrow a “covered” rural carrier classification or not. Since TNRM-eligible carriers are able to maintain terminating access rates at levels much higher than ICRM-eligible carriers, less of a carrier’s revenue requirement would be shifted, and a smaller percentage of the covered rural carrier’s revenue requirement would have to be recovered from this fund. A much higher percentage would have to be recovered for rate of return carriers in the ICRM fund.

Furthermore, the ICF plan’s ICRM can be competed away. Thus, although the fund purports to replace funds no longer available through access charges, that replacement funding may be distributed to a competing carrier. If that occurs, the purpose of the fund is not served – the affected carrier is not put in a position of recovering its costs. The ICF plan thus favors the customers of its “covered” rural carriers, and it improperly harms the customers of all other small rate-of-return carriers.

Certainly, participating in an ARM that provides reliable assurance of revenue recovery is better than having no alternative source of revenue. Having said that, the application of the various plans with ARMs to SureWest presents special issues. SureWest believes that the ARM arrangements, as applied to it, are inferior as revenue substitutes to simply maintaining access rates at or near current levels (or at lower levels that would nevertheless be higher than some of the ones proposed.)[32] Certainly there are options whereby access rates need not be reduced so low that revenue

[32] In either case, the size of the ARM needed to make affected carriers whole would be much smaller.

recovery must be forced on SureWest through an ARM, rather than a market-based access charge source. On balance, ARMs as a substitute for market-based customer payments would operate to the detriment of SureWest.

The ICF Plan would reduce most carriers' traffic-sensitive switched access charges by more than 99%. With respect to carriers such as SureWest Telephone, any plan that prescribes a significant reduction in access rates would threaten its revenue base in ways that violate the Communications Act's principles on prescription of rates. Under such principles, a rate of return carrier must be allowed a fair chance to recover its costs and earn a reasonable rate of return.

The ARM as an alternative revenue source also creates a separate issue that imposes new risk and can uniquely threaten SureWest. With any plan that moves usage based rates close to zero, and holding its current state support levels constant, SureWest would have to receive an amount that could be up to 10 times what it otherwise would have received at the interstate level to put it in the position it would have been in had there been no such new plan. Such a payment, combined with existing common line and state level support, would make government support funds the majority source of SureWest Telephone's non-local rate revenue.

In SureWest's view, this is a negative public policy step that adds a new dimension of financial risk. Instead of being able to recover most of its costs from a diverse array of cost causing access customers, SureWest Telephone would now be reduced to receiving a substantial portion of its revenue requirement from a new and untested government support fund. Intercarrier compensation reform should not independently increase the cost recovery risk on ILECs by substituting a single government-dominated revenue source (highly subject to future political influences) for a currently diverse revenue base of customers. This type of shift fundamentally changes the nature of a carrier's business.

Why should SureWest be concerned about losing its customer revenue diversification? Portfolio diversification is an age-old concept that offers a basic avenue to reduce risk. The phrase "don't put all your eggs in one basket" existed long before modern finance theory. The value to SureWest of diversifying its revenue sources is comparable to the value to an individual investor of diversifying his or her investments. Diversification of this "portfolio" avoids excessive exposure to any one source of revenue and reduces its variability.[33] The power of diversification is such that it can actually reduce certain forms of non-systemic financial risk to zero. In contrast, reducing diversification is not good – especially when it is not offset by any other public interest benefits.

A "portfolio" of different customer revenue sources can be called well-diversified if it includes a wide number of such revenue sources, and the contribution received from any single one is small.[34] The proportion of any single revenue source in a well-diversified portfolio is small enough if, for all practical purposes, a reasonable change in it would have a negligible effect on that portfolio's overall return.[35] Clearly, that is no longer the case for SureWest if it must rely on support funds for revenue at the level contemplated by some of the usage-based rate reductions and large shifts of revenue recovery to ARM mechanisms. In the telecommunications sector, this suggests that, while an ILEC cannot eliminate the potential that it could be harmed by some of the

[33] See Principles of Corporate Finance, Richard A. Brealey and Stewart C. Myers (McGraw-Hill, Inc., 1991) at 137.

[34] Investments, at 319

[35] Id.

risks that are shared by all of its interexchange carrier access customers, or shared by all of its CLEC access customers, or shared by all of its ISP access customers, having a diverse set of such customers minimizes the risk associated with any particular category. The wider it can make such diversification, the more its revenue base volatility falls, and the lower and less abrupt the potential exposure to factors that are unique to any single source of revenue.[36] This provides assurances that the average residential customers will not be detrimentally affected by circumstances limited to the largest source of ILEC revenue.

In contrast, a portfolio dominated by only one or a few revenue sources is highly influenced by risks specific to those sources. An ARM that replaces a carrier's diverse source of revenue with one dominant form of compensation poses these same types of risk. If SureWest's current carrier revenue base is destroyed by a prescriptive rate that is for all practical purposes zero, it will face more risk -- even if that base actually is replaced dollar-for-dollar by ARM revenues.

SureWest has attempted to measure the size of this risk by attempting to estimate the impact of the ICF plan on its own operations. SureWest has used ICF data and various estimation techniques, and its calculations are borne out using ICF data, once corrected for its errors. Projections of declining access lines and other factors do not change the analysis. A rough estimate of the impact of the ICF plan indicates that SureWest's combined intrastate and interstate switched access revenues would fall to near zero by the fourth year of that plan. In order to be made whole for that shift, and

[36] This is often called the "insurance principle", because of the belief that insurers depend on the risk reduction achieved through diversification when writing many policies affected by independent sources of risk, with each policy being only a small part of the overall portfolio. While this can't protect against market-wide risk sources, often called non-diversifiable risk, it can protect well against unique, or non-systematic risk – risk that is peculiar to the individual source.

assuming that SLCs are capped and USF funding is unavailable, either each SureWest customer would have to bear an additional cost burden per access line of approximately $7 per month ($84 per year), or that sum would have to come from an ARM. Thus, while the presence of an ARM would certainly be preferable to no revenue replacement at all, the size required to allow SureWest to recover its costs would create a regulatory risk that is inconsistent with the public interest in ensuring universal service and maintaining a high quality network.

X. ASPECTS OF VARIOUS PLANS CAN LEAD TO A BETTER PUBLIC INTEREST RESULT.

SureWest expects that most comments in this proceeding will provide only general themes for Commission action. SureWest believes that the Commission should move in the following direction: First, ILEC networks have significant value to all who use them, and there is a good basis for all users of local networks to compensate local carriers for that use. Access rates that are for all practical purposes at or near zero do not do this, and create new and dangerous arbitrage opportunities.[37]

Second, there is no need to force ILEC switched access rates for circuit-based services down as far as has been proposed in some plans, ultimately requiring the replacement of those losses with offsetting governmental supports. One guiding principle in this proceeding should be to seek to limit aggregate rate reductions on balance to what could be recovered in offsetting modified SLCs. While this may not necessarily be enough to deflate the most significant incentives for arbitrage, it will provide the Commission with an initial assessment of what can be more easily done, and the remaining issues that would require careful public interest balancing.

[37] As noted above, a new form of arbitrage can emerge vis-a-vis ILECs and that would exacerbate ILEC risk, as set out in footnote 9.

Third, if there is compelling need for further access reductions, some mechanism for cost recovery is essential for ILECs to be able to continue to deliver good service to their customers. This could be achieved with the use of alternative rate elements that operate consistently across customer groups (including a small flat rate originating charge on all connections), or through an ARM mechanism that is carefully balanced with usage based rate changes and SLC adjustments. Since the purpose is to permit full cost recovery, the Commission should not discriminate among ILECs in eligibility for ARM fund, nor should conditions for recovering from it differ among carriers. There is no need for more than one fund.

However, since any new support mechanism should not operate to make ILECs dangerously dependent on indirect support fund payments, this also lends strength to the view that usage-based rate reductions be measured, and that alternative revenue sources be preserved. Otherwise, any new ARM fund could fundamentally change the nature of what should be an independent and privately controlled ILEC segment. However, if rate adjustments to usage-based rates are made that require use of an ARM mechanism, every affected ILEC would need to participate in such a fund, rather than be left without an alternative source of recovery.

Fourth, if the Commission determines that economic efficiency is to be the key principle in this proceeding, it should act on the conclusion in an even-handed fashion with respect to both usage based rates and flat rates. If the Commission elects to cap upward movement of SLCs, then it would appear to be equally appropriate for it to determine that it can also limit the downward movement of per-minute rates. Otherwise, the result would be inherently uneconomic and discriminatory.

Finally, while the FNPRM does not directly request comments beyond reform of intercarrier compensation mechanisms, achievement of the full public interest requires concurrent action to deal with outstanding universal service issues as well, including making collection and distribution methods more fair.

XI. CONCLUSION

The record appears inadequate to make an informed and rational decision on the complex and optimum steps that would serve the public interest in this proceeding. However, if the Commission takes action in connection with the FNPRM, it should do so consistent with the principles set out in these comments. Finally, the issues faced by SureWest and certain other carriers in this proceeding are unique, and could potentially have significant impacts upon these carriers' continued ability to meet their common carrier obligations. Rational decision-making in this proceeding will require the Commission to review and consider the impact on *all specific* carriers, not just on generic categories of carriers.

Respectfully submitted,

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APPENDIX A – COMMENTS ON OTHER PLANS AND PROPOSALS

A. HOME TELEPHONE PLAN

The Home Telephone plan is a plan that offers a variation on the EPG plan. This plan lacks specific detail adequate to review its impacts. The primary difference from the EPG plan is a new end user connection charge would be developed to recover a portion of the revenue shortfall, rather than using a pooled mechanism.

The Home Telephone plan seeks a framework that could be used for both legacy and Next generation networks. The single biggest problem would be the determination of the level of cost averaging for a connection-based methodology. Rates based on a connection based methodology could create new arbitrage opportunities, especially in low cost, high volume areas, causing a need for constant revision. Also, new rates could be non-competitive for businesses if averaged indiscriminately.

This plan carries with it the same concern about circuit- or system loading as the EPG plan. Even though the intrastate and interstate jurisdictions may be unified, the DS-1 level of interconnection may be abused with customers sending traffic loads significantly higher than previously on a DS-1 connection basis. This has been a regulatory concern since the days of ENFIA at the Commission.

The plan supports immediate implementation of the newly defined connection flat fees and increases in end user charges to a Federal cap. This provides no phased-in “glide path” into the new plan, and therefore there are risks for carriers who implement the plan and find it has problems. With flash-cut implementation of SLC and DS-1 charges, the plan provides for a shortfall of revenue to be recovered through a form of ARM called the High Cost Connection Fund (HCCF), which spreads costs more broadly than is currently the case. The rate of about $1 per month per NANP number is considerably less than the current 11.1% USF contribution rate. This recovery fund would be funded from contributions from broadband carriers and Internet operations obtaining numbers from NANP, similar to that of other ARM proposals. Concerns about the funding and use of an ARM structure are roughly the same as are addressed in the comments.

B. CBICC PLAN

The CBICC proposal has very little detail, but relies essentially on a unified access rate that is based on a TELRIC methodology. SureWest shares the concerns identified by USTA with the TELRIC methodology, and believes that this forward looking methodology does not properly reflect ILEC costs in the marketplace. In addition, rather than dealing with rate issues in a unified way, CBICC relies on the states to transition to intrastate rates that mirror the baseline interstate rates. This provides incentives for continued arbitrage based on terms, conditions, price and timing. Lastly, the objective of this plan appears to be to seek ways to drive down CLEC interconnection costs and other applicable charges for ILEC network use, and to promote opportunities for other cost reductions. It is far too one-sided. Similarly, the plan also provides CLECs with a unilateral right to determine points of interconnection with ILECs. This is inferior to having a clear blueprint that is objectively fair.

C. WESTERN WIRELESS PLAN

The Western Wireless plan proposes principles for operating under a bill-and-keep arrangement. As expressed in these comments, SureWest does not believe that bill-and-keep serves the public interest.

More basically, the principles consider cost recovery for ILECs as unnecessary, and instead focus on alleged economic efficiency. This approach ignores the mandates of the Act with respect to rate of return ILECs and others. It also does not take into consideration the continuing need for ILECs to maintain the network facilities which are critical to both wireline and wireless providers.

This plan calls for unified rates and extension of the universal service contribution base. This is acceptable. However, the injection of a portability element for an ARM-type support structure results in the transfer of what may be viewed as something derived from and of value for an ILEC to others. This has questionable public interest value.

D. NARUC principles

The NARUC document is not a plan, and it provides no details, only general principles. SureWest is unable to support the principles in the abstract as a statement of possible regulatory action because each principle is subject to widely disparate interpretations. However, SureWest believes the principles will be increasingly untenable as market forces and technological changes challenge current services and rate methodologies. There is no plan within the principles to deal with known arbitrage issues, network architecture problems or the unified ratemaking necessary to transition to a better intercarrier compensation system.

E. NASUCA proposal

The NASUCA proposal is of limited value here. An interstate rate designed to seek the level of access charges closer to zero is targeted; however, the target rate would not be workable for most small and midsize ILECs. There is no plan on how to address arbitrage issues between the state and interstate jurisdictions, except to “encourage” the states to match the interstate rate. There is little accommodation for the massive shortfalls of revenue incumbents would face with a large reduction in usage rates, and it seems clear that NASUCA would oppose the remaining avenue of increasing local rates. The proposal also would not allow any increases in the SLC.

Additional high-cost support would be provided only to rural carriers on a case by case basis, while non-rural carriers would receive high-cost support based on rate comparability mechanisms. If federal high-cost support is based on national state averages as it is today, this would continue to make SureWest subject to a discriminatory arrangement that allows USF funds to flow to less-needy ILECs in states with average rates that are higher than those that prevail in California.